August 31, 1951

Professor Walter J. Blum
The Law School
University of Chicago
Chicago 37, Illinois

Dear Blum:

I was not able to tell you over the telephone certain aspects of the tax scheme which I presented to you and which I would like you to scrutinize with respect to the treasury's attitude in the matter.

The tax scheme has two applications:

1) I could use it to invest my own money and the money of other people in low income tax brackets who wish to secure a large income on a small capital investment.

2) I could make it possible for the University to get a very high return on safe investments, thereby enabling the University to raise the salaries of all professors including my own.

One variant of the tax scheme is illustrated in the following example:

Let us assume that the net return on investment in real estate is 6% which takes into account that there is a 2% yearly depreciation on the property. Let us now take a man in the 80% income tax bracket who buys a piece of real estate for $20,000 and obtains a bank loan on it of $15,000 at 5% interest for five years. (First mortgages up to 75% of the value of the real estate are at present obtainable in Denver). This man has to put in $5,000 of his own money at the time of the purchase. Six months later he sells this property to me under the following terms: I pay him at the time of the purchase

$5,000 (thus the man has none of his own money left in the venture), five years later the value of the property will be appraised and I shall then pay him a sum equal to the appraised value, less $500. If there is no change in the market for real estate the property ought to sell (taking into account 2% depreciation per year) at $18,000. If I then sell the property at the end of five yearz at $18,000 I shall retain $500 and will discharge all my obligations by paying off the remaining $17,000.

Now how does this shape up from the point of view of the man in the high income tax bracket? He has made a capital gain of $2,500 on the deal. On the other hand he has paid in interest during these five years a total of $3,750 which, being deductable from income, will cost him only $750. He is taking a chance of losing on the deal if the real estate market deteriorates, but in these days it is more likely that real estate prices will go up in the next five years and he has an additional capital gain if they do.

How does the deal shape up from my point of view? I have invested $5,000 and during the five years I shall have an income of $1600 per year (8% of $20,000 since I do not have to make allowance for capital depreciation). My total income during the ~~next~~ five years is then $9,000 and at the end of the five years I get another $500 giving me a total return of $9,500 in five years on an investment of $5,000.

I shall pass through Chicago early next week and should like very much to hear from you then if there is anything wrong with this scheme.

Sincerely,

Leo Szilard

LS/db

P.S. In order to apply this scheme to raising the income of the University one could approach men in high income tax brackets who would be glad to give a "donation"

P.T.O.

to the University, but have already reached the limit of their "charitable contributions" which they can deduct from income. —

Such men might be willing to forgo any profit on a transaction of the type described ~~above~~ and to regard the interest payments they assume as their "contribution" to the University. In this case the University could make in 5 years $12000 on a ~~dollar~~ $5000 investment. (The University would pay $5000 at the time of the purchase and five years later sell the property and make a final payment of the sales price less $3000)

THE UNIVERSITY OF CHICAGO
CHICAGO 37 · ILLINOIS
THE LAW SCHOOL

September 7, 1951

Dr. Leo Szilard
c/o B. A. Silard
Photo-Volt Corporation
95 Madison Avenue
New York, New York

Dear Leo:

I have one almost immediate reaction to the latest modification of your plan. It concerns the new wrinkle of a second mortgage loan of short duration from Szilard to the man of wealth. When such a loan, which is in itself an oddity, is linked to a commitment by Szilard to purchase the property, it appears as though the sale from the man of wealth to Szilard takes place when the contract is made rather than when the formal sales transaction is completed. If this result is reached the gain to the man of wealth is a short-term rather than a long-term capital gain.

It seems to me that the short-term loan on a second mortgage is not a necessary part of your scheme. The capitalist ought to be willing to put up $5,000 of his own money for a period of six months to get the benefits which are in store for him. Doing so would avoid having the plan upset for the reason I have suggested.

Again I think it ought to be emphasized that the "success" of the plan depends on the skill with which the interest component in your payments to the capitalist are camouflaged as part of the capital sum which is involved. The trimmings which help in accomplishing this camouflage are worthwhile; all the other trimmings in the plan are unnecessary and are likely to arouse suspicion.

I hope you will be able to eat filet mignon daily.

As ever,

Walter

Walter Blum

WB:ct

VIA AIRMAIL

Maurice Preville

[Bardon, Co]

~~Vox~~ Thomp-Stor

N26 pf

Spring 1940

guess 10 Barnes. ~1 lbs

Frisch-Peierls

May 1940 x

Report to Tizard

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about same time

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Committee set up

by July 1940 (Maud Cttee)

Simon Peierls Halban

Kowarski Frisch

~~Frisch~~ Tube 1941

Christy Lauritsen ~~Brittany~~ Summer

September 26, 1951

Mr. Walter J. Blum
The Law School
The University of Chicago
Chicago 37, Illinois

Dear Blum,

I am considering taking a leave-of-absence as a professor and applying for a job with the Central Administration to work on the improvement of the finances of the University, provided I can see my way clear to effect such improvement. The following is a scheme concerning fund-raising and investment which is submitted to you for your scrutiny.

The basic idea of the scheme is illustrated in the following: We go to some wealthy man, say Mr. Smith, who is in a high income tax bracket. If he invests in stocks at all, he will not do so for the sake of the dividends on which he has to pay income tax. He should be interested, however, in investing in stocks for the sake of capital gain, if we can indemnify him to a considerable extent against a possible capital loss.

We propose to Mr. Smith the following deal: He sells the University stock of a type mutually agreed upon after he has held such stock for over six months. Let us assume that at that time the stock has a value of $1,000,000. and can be expected to pay a dividend of X100,000 ~~$60,000~~. per year.

The University shall buy this stock under the following terms: A small down payment is made by the University at the time of the purchase. The rest of the purchase price will be paid to Mr. Smith at the end of a period of five years. At the end of five years the University will pay Mr. Smith 700,000 ~~$650,000~~. and one-half of whatever the market value of the stock is at that time. In case the value of the stocks goes down to such an extent that Mr. Smith would have a net capital loss on the transaction, the University shall indemnify Mr. Smith against such a capital loss except that the University shall not pay Mr. Smith more than the value of the stocks at the end of the five-year period plus $500,000.

Assuming that the value of the stocks does not change over the five-year period, Mr. Smith will make a capital gain of ~~$150,000.~~ 200,000. If the price of the stock goes up, he will benefit from the price increase to the extent of fifty per cent. In case the price of the stocks goes down, Mr. Smith will have no capital loss unless the price of the stocks falls below ~~$400,000.~~ $500,000

Assuming that the stocks bring the University an income of ~~$60,000.~~ $100,000 per year, the dividends will total in five years $500,000. If the price of the stocks does not rise over this five-year period ~~but just maintains its level~~ whatever its level, the University will make on this deal ~~$150,000.~~ 300,000 + plus interest accumulated on the dividends received. If the price of the stocks rises, the University will benefit from it to the extent of fifty per cent. If the value of the stocks should fall, the University will make less than ~~$150,000.~~ 300 000 but in no case can the University lose, assuming that the dividends over the five-year period average ~~$60,000.~~ $100 000 per year.

It might be advisable to leave both the University and Mr. Smith the right to ask for a settlement prior to the lapse of five years at any time. In case of such an early settlement, the purchase price would be fixed at a sum between $500,000. and ~~$650,000.~~ 700 000, depending on the time of the settlement, plus half the price of the stocks at the time of the settlement. The University will indemnify Mr. Smith against a capital loss, but the University will pay no more than the price of the stocks and a sum which will be fixed at some value below $500,000. depending on the time of the settlement.

As an alternative in order to make the deal more attractive to Mr. Smith, we might fix the purchase price not at ~~$650,000.~~ $700 000 and half the price of the stocks, but rather at $500,000. plus three-quarters of the value of the stocks while leaving all the other conditions of the deal unchanged. This would give Mr. Smith a greater share in the gain if the price of the stocks rises.

Mr. Smith does not have to put up $1,000,000. of his own money in order to enter into such an arrangement. He may take up a loan of, say, $500,000. using the stocks as security. On this loan he might have to pay as much as five per cent of interest but if he is in the eighty per cent income tax bracket, the interest payment would cost him over a five-year period in toto only $50,000. When the University buys the stock from Mr. Smith it would, of course, not assume the loan even though the stocks may continue to serve as security against the loan. If the price of the stocks does not change over the period of five years, Mr. Smith would then make a capital gain of $1~~50~~ 200,000. on a $500,000. investment, against which he may have spent ~~expense~~ ~~a loss of~~ $50,000. after taxes.

An analogous deal could be proposed based not on stocks but on real estate. Here it might not be possible for Mr. Smith to use the real estate as security for a loan by giving a mortgage to some bank since, I understand, if there is a mortgage against the property the University will have to pay taxes on the corresponding part of the income derived from the property. Mr. Smith would, therefore, have to take a bank loan for five years if he wishes to reduce the amount of his own money invested in the deal.

At this time it appears possible that the deal based on certain types of real estate might offer ~~greater advantages~~ less risk than the deal based on stocks since it should be possible to find certain types of real estate where one can be fairly sure there will be no decrease in the market price. It might be that at this time reliable stocks are overpriced and if that is so then this would not be a particularly good time for entering into the type of deal proposed above on the basis of stocks. This point will have to be further examined.

With kind regards,

Sincerely,

Leo Szilard

THE UNIVERSITY OF CHICAGO
CHICAGO 37 · ILLINOIS
INSTITUTE OF RADIOBIOLOGY AND BIOPHYSICS

September 27, 1951

Mr. Walter J. Blum
The Law School
The University of Chicago
Chicago 37, Illinois

Dear Blum,

I am considering taking a leave-of-absence as a professor and applying for a job with the Central Administration to work on the improvement of the finances of the University, provided I can see my way clear to effect such improvement. The following is a scheme concerning fund-raising and investment which is submitted to you for your scrutiny.

The basic idea of the scheme is illustrated in the following: We go to some wealthy man, say Mr. Smith, who is in a high income tax bracket. If he invests in stocks at all, he will not do so for the sake of the dividends on which he has to pay income tax. He should be interested, however, in investing in stocks for the sake of capital gain, if we can indemnify him to a considerable extent against a possible capital loss.

We propose to Mr. Smith the following deal: He sells the University stock of a type mutually agreed upon after he has held such stock for over six months. Let us assume that at that time the stock has a value of $1,000,000. and can be expected to pay a dividend of $100,000. per year.

The University shall buy this stock under the following terms: A small down payment is made by the University at the time of the purchase. The rest of the purchase price will be paid to Mr. Smith at the end of a period of five years. At the end of five years the University will pay Mr. Smith $700,000. and one-half of whatever the market value of the stock is at that time. In case the value of the stocks goes down to such an extent that Mr. Smith would have a net capital loss on the transaction, the University shall indemnify Mr. Smith against such a capital loss except that the University shall not pay Mr. Smith more than the value of the stocks at the end of the five-year period plus $500,000.

Assuming that the value of the stocks does not change over the five-year period, Mr. Smith will make a capital gain of $200,000. If the price of the stock goes up, he will benefit from the price increase to the extent of fifty per cent. In case the price of the stocks goes down, Mr. Smith will have no capital loss unless the price of the stocks falls below $500,000.

Assuming that the stocks bring the University an income of $100,000. per year, the dividends will total in five years $500,000. If the price of the stocks does not rise over this five-year period but just maintains its level, the University will make on this deal $300,000 plus whatever interest it accumulates on the dividends received. If the price of the stocks rises, the University will benefit from it to the extent of fifty per cent. If the value of the stocks should fall, the University will make less than $300,000. but in no case can the University lose, assuming that the dividends over the five-year period average $100,000. per year.

It might be advisable to leave both the University and Mr. Smith the right to ask for a settlement prior to the lapse of five years at any time. In case of such an early settlement, the purchase price would be fixed at a sum between $500,000. and $700,000., depending on the time of the settlement, plus half the price of the stocks at the time of the settlement. The University will indemnify Mr. Smith against a capital loss, but the University will pay no more than the price of the stocks and a sum which will be fixed at some value below $500,000. depending on the time of the settlement.

As an alternative in order to make the deal more attractive to Mr. Smith, we might fix the purchase price not at $700,000. and half the price of the stocks, but rather at $450,000. plus three-quarters of the value of the stocks while leaving all the other conditions of the deal unchanged. This would give Mr. Smith a greater share in the gain if the price of the stocks rises.

Mr. Smith does not have to put up $1,000,000. of his own money in order to enter into such an arrangement. He may take up a loan of, say, $500,000. using the stocks as security. On this loan he might have to pay as much as five per cent of interest but if he is in the eighty per cent income tax bracket, the interest payment would cost him over a five-year period in toto only $50,000. When the University buys the stock from Mr. Smith it would, of course, not assume the loan even though the stocks may continue to serve as security against the loan. If the price of the stocks does not change over the period of five years, Mr. Smith would then make a capital gain of $200,000. on a $500,000. investment, against which he may have spent $50,000. after taxes.

An analogous deal could be proposed based not on stocks but on real estate. Here it might not be possible for Mr. Smith to use the real estate as security for a loan by giving a mortgage to some bank since, I understand, if there is a mortgage against the property the University will have to pay taxes on the corresponding part of the income derived from the property. Mr. Smith would, therefore, have to take a bank loan for five years if he wishes to reduce the amount of his own money invested in the deal.

It might be that at this time reliable stocks are overpriced and if that is so then this would not be a particularly good time for entering into the type of deal proposed above on the basis of stocks. At this time it appears possible that the deal based on certain types of real estate might offer less risk than the deal based on stocks since it should be possible to find certain types of real estate where one can be fairly sure there will be no decrease in the market price. This point will have to be further examined.

With kind regards,

Sincerely,

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Leo Szilard

September 30, 1951

Mr. Walter J. Blum
The Law School
The University of Chicago
Chicago 37, Illinois

Dear Blum,

During the last few weeks I have discussed with you various aspects of a scheme which aims at increasing the University's income "from investment". You will find in this letter the versions which I favor at present and which are herewith submitted to you for your kind scrutiny and final judgment.

The basic idea of the scheme is illustrated in the following: We go to some wealthy man, say Mr. Smith, who is in a high income tax bracket. If he invests in stocks at all, he will not do so for the sake of the dividends on which he has to pay income tax. He should be interested, however, in investing in stocks for the sake of capital gain, if we can indemnify him to a considerable extent against a possible capital loss.

We propose to Mr. Smith the following deal: He sells the University a certain quantity of stock of a kind mutually agreed upon after he has held such stock for over six months. Let us assume that at the time of the sale the stock has a value of $1,000,000. Let us further assume that the stock pays at present a dividend of eight per cent, and that we consider it very unlikely that the dividends should average in the next five years less than four per cent.

On the basis of these assumptions, the University would buy this stock under the following terms: A small down payment is made by the University at the time of the purchase. The rest of the purchase price will be paid to Mr. Smith at the end of a period of five years. At the end of five years the University will pay Mr. Smith $700,000. and one-half of whatever the market value of the stock is at that time. In case the value of the stocks goes down to such an extent that Mr. Smith would have a net capital loss on the transaction, the University shall indemnify Mr. Smith against such a capital loss except that the University shall not pay Mr. Smith more than the value of the stocks at the end of the five-year period plus $200,000.

Assuming that the value of the stocks does not change over the five-year period, Mr. Smith will make a capital gain of $200,000. If the price of the stock goes up, he will benefit from the price increase to the extent of fifty per cent. In case the price of the stocks goes down, Mr. Smith will have no capital loss unless the price of the stocks falls below $800,000.

Assuming that the stock pays the University in dividends $80,000. per year and that the dividends are reinvested in the same stock, the University's income from the stock will then total in five years slightly more than $464,000. If the price of the stock does not rise over this five-year period but just maintains its level, the University will then make on this deal — in which it has none of its own capital invested — $264,000. If the price of the stock rises, the University will benefit to the extent of fifty per cent of the rise. If the dividends average less than eight per cent and if the price of the stock should fall over the five-year period, the University will then make less than $264,000. Yet the University cannot lose on this deal as long as the dividends from the stock average about $40,000. per year.

As an alternative in order to make the deal perhaps more attractive to Mr. Smith, we might fix the purchase price not at $700,000. and half the price of the stocks, but rather at $400,000. plus three-quarters of the price of the stocks while leaving all the other conditions of the deal unchanged. This would give Mr. Smith a greater share in the gain if the price of the stocks rises and would still give him a capital gain of $150,000. if the price of the stocks remains unchanged.

Mr. Smith does not have to put up $1,000,000. of his own money in order to enter into such an arrangement. He may take up a loan of, say, $500,000. using the stocks as security. On this loan he might have to pay four per cent interest but if he is in the eighty per cent income tax bracket, the interest payment would actually cost him over a five-year period only $40,000. in toto. When the University buys the stock from Mr. Smith it would, of course, not assume the loan even though the stocks may continue to serve as security against the loan. If the price of the stocks does not change over the period of five years, Mr. Smith would then make a capital gain of $200,000. on a $500,000. investment, against which he may have an expense of $40,000. after taxes.

The University might make such a deal with a number of men who wish to sell stock to the University under terms similar to those outlined above. In order to facilitate such deals, the University would draw up a list of stocks which it considers safe investments and which it might be prepared to buy under such terms.

The University is, of course, not obliged to hold for five years the stocks which it buys. It can sell any stock any time it pleases and it might purchase other stock in its place.

I wonder whether we would run into difficulties because of existing tax laws or security exchange regulations if the following policy were adopted:

Clearly it would be advisable for the University, if it makes major changes in its portfolio of stocks, to cover itself by modifying the agreement with Mr. Smith and the others from whom it has purchased stocks under this plan. At the time when it wishes to sell stock A , which it has purchased from Mr. Smith,in order to replace it with stock B, the University might in order to cover itself propose to Mr. Smith that the agreement between them be modified as follows:

The University will pay after the lapse of five years to Mr. Smith not half the market price of the originally purchased quantity of stock A but rather half the market price of a corresponding quantity of stock B. What corresponding quantities are,is determined by the market price of these stocks at the time the agreement is modified. If Mr. Smith agrees to this modification, the University would then actually sell stock A and purchase stock B in its place.

Similarly Mr. Smith might perhaps propose at some time to the University that some modification of the agreement of this type be made. As long as the shift goes from stock A to another stock B, which are both on the list drawn up by the University, there seems to be no reason why the University should not accede to a request of this sort from Mr. Smith, even though it would have no legal obligation to do so.

The University would reserve the right to settle its obligation to Mr. Smith earlier than after the lapse of five years on the following terms:

In case of an earlier settlement requested by the University, the purchase price shall be fixed at a sum between $500,000. and $700,000. corresponding to the time of the settlement. The University will indemnify Mr. Smith against a capital loss but the University will pay no more than the price of the stocks plus a sum which, corresponding to the time of the settlement, will be at a value between 0 and $200,000. Mr. Smith shall have no legal right to ask for an early settlement but the University might adopt a policy of agreeing to such an early settlement on the above terms as an act of courtesy to Mr. Smith.

If the University hesitates to purchase stocks on some such terms because she does not want to take the risk of a loss however slight or because she is reluctant to make use of her tax exemption with respect to income derived from such stock purchase, there seems to be an alternative way of proceeding which avoids these objections, as follows:

A few friends of the University shall create a corporation and give to the University more than ninety per cent of the shares free of charge with the sole condition attached that in the first five years any dividends which might be paid on these shares to the University will be currently reinvested by the University in the Corporation. This Corporation would purchase stocks from Mr. Smith and others in the manner described above. The Corporation would not be tax exempt; it would pay taxes on the dividends received from its holdings of stocks but only on fifteen per cent of these dividends; i.e. only about seven and one-half per cent of its total income from dividends would go for income tax. At the end of the five-year period, there might be some capital gain on which the Corporation would have to pay a capital gain tax. The assets of the Corporation which remain, after discharging all its obligations at the end of the five-year period, might then be paid out one way or another to its shareholders.

During the five-year period the Corporation would currently distribute its income in the form of dividends to its shareholders but since more than ninety per cent of these go to the University and are reinvested by the University in the Corporation, more than ninety per cent will remain available to the Corporation for discharging its obligations up to the end of the five-year period.

Clearly this scheme could be set up in a manner in which the University could not possibly suffer a financial loss. The tax exemption of the University is not directly involved except perhaps inasmuch as the University pays no tax on the dividends received from the Corporation and, therefore, is in a position to reinvest in the Corporation in full these dividends during the five-year period.

The Corporation could be incorporated in the State of Delaware and the shares given to the University could be non-voting shares so as to relieve the University of any care or responsibility.

Finally we should also investigate the possibility of using some corporation of which the University already holds most of the shares (I wonder whether this is the case for Encyclopaedia Britannica) after a slight modification of their charter and perhaps some redistribution of their stock, in place of an ad hoc created corporation.

With kind regards,

Sincerely,

Leo Szilard

m

Copy

THE UNIVERSITY OF CHICAGO
CHICAGO 37 · ILLINOIS
INSTITUTE OF RADIOBIOLOGY AND BIOPHYSICS

1155 East 57th Street
October 2, 1951

Mr. Walter J. Blum
Law School
The University of Chicago
Chicago 37, Illinois

Dear Blum:

This letter deals with the modification of the scheme presented to you in the letter dated September 30, 1951. In this modification, Mr. Smith has, during the 5 year period, no money of his own invested and such small risk of financial loss as the University had under the previous scheme is further reduced to the vanishing point. The scheme is as follows:

Let us assume the University has in its portfolio $500,000 worth of a certain stock A and that Mr. Smith has owned for over a period of 6 months $1,000,000 worth of the same stock A. Let us further assume that Mr. Smith has borrowed from some bank $500,000 against this stock as security on which he is paying 5% interest (5% may be too high a value but we use it in order to simplify the computations).

In the following we shall assume that Mr. Smith is in the 80% income tax bracket, that the yearly dividend paid on $1,000,000 worth of stock A is about $50,000, i.e. 5% of today's market price, and that the University believes that the dividends over the next 5 years will be in toto certainly in excess of $200,000, i.e. that the dividends will average not less than 2% of today's market price.

The University purchases today from Mr. Smith $1,000,000 worth of stock A. It does not assume the loan, but permits Mr. Smith to use the stock as security. The terms of the purchase are as follows: The University will pay Mr. Smith, after a period of 5 years, one-half of the price of the stock at the time plus $675,000. In case this would result in a capital loss to Mr. Smith, the University will indemnify Mr. Smith against such a capital loss, provided however that the University will not pay Mr. Smith more than the market value of the stock plus $175,000.

The University gives an option to Mr. Smith for a loan of $500,000 at 5% interest with the provision that this loan cannot be called by the University prior to the end of the 5 year period.

If Mr. Smith exercises this option, as he will probably do soon after selling the stock to the University, the University will then sell from its own portfolio $500,000 worth of stock A on the market and thus make the funds available for the loan to Mr. Smith.

Assuming that Mr. Smith exercises the option for the loan, the deal shapes up for him as follows: He will have none of his own money invested. He will pay in interest a total of $250,000 over the 5 year period, but since he is in the 80% income tax bracket this will actually cost him only a total of $50,000. If the price of the stock is neither up nor down at the end of the 5 year period, he will make a capital gain of $175,000. If the price of the stock has gone up, he will get an additional capital gain amounting to the price increase on one-half of the stock. If the price of the stock has gone down, Mr. Smith will have no capital loss unless the price of the stock has fallen from $1,000,000 below $825,000.

From the point of view of the University, the deal shapes up as follows: If the stock yields 5% dividends and if the dividends are re-invested, the University will have, as the result of the deal, an additional income of $137,500 from dividends on half of the stock for the 5 year period, and it will have from interest, collected over a 5 year period, an income of another $137,500 or, in toto, $275,000. Therefore, if the price of the stock has not fallen at the end of the 5 year period and the dividends average 5% of today's market price, the University will make on this deal a profit of $100,000. If the price of the stock has risen at the end of the 5 year period, the University will make, as a result of the deal, a corresponding capital gain on one-half of the stock.

If the dividends average less than 5% and if the price of the stock is down at the end of the 5 year period, the gain of the University on the deal will be less than $100,000. If the dividends were to average only 2% and if the dividends were reinvested, the University's income from the deal would be on dividends on half of the stock, about $52,000 over the 5 year period, and its income from interest would remain unchanged at $137,500, so that the University's income from these two sources would be $189,500. Thus it may be seen that the University cannot lose on this deal as long as the average dividend does not fall below 2%.

It seems to me that a deal of this type is advantageous both for the University and for Mr. Smith, provided the deal is made at a time when stocks are not over-priced. The question remains whether the treasury might object to Mr. Smith's claiming capital gain and this is a point about which Mr. Smith's legal advisers may have some comment to make.

Sincerely yours,

Sz.

Leo Szilard

LS/sds

To: Walter Blum
From: Leo Szilard

To Blum: this is slightly changed from what I told you over the telephone. Shall discuss it with you next week if I may. L. Sz.

June 18, 1953

MEMORANDUM CONCERNING SALE OF STOCK TO THE UNIVERSITY OF CHICAGO

The purpose of this memorandum is to raise certain legal questions by means of a concrete example.

A Closely Held Corporation with, say, 1,500,000 shares issued is reorganized so that the stockholders obtain in place of the presently held shares 1,500,000 new shares, of which 15,000 are A Shares and the rest are C Shares.

These shares are issued with the following provisions: While the A Shares may receive dividends in the first four years, the C Shares will receive no dividends in the first four years. After four years, both the A Shares and the C Shares will be converted into B Shares. At that time one B Share will be given in exchange for one A Share and one B Share will be given in exchange for one C Share. There is a further provision which says that during the first four years the net current profits must be paid out in full in the form of dividends. It is contemplated to ~~have~~ introduce ~~a stock issue of~~ the B Shares on the Stock Exchange sometime within three years after the conversion of the A Shares and C Shares into B Shares.

Let us assume now for the sake of the example, that the company has a net profit of $1.00 per share per year and that there will be almost certainly a total net profit of $1,500,000. during the year in which it is reorganized and a likelihood that the net profit of the company might remain at $1.00 per share in the subsequent years.

Under these assumptions, the present shareholders might be willing to part with the B Shares when the stock is ~~poured out~~ introduced ~~into~~ on the stock market at perhaps 6 times earning, i.e. $6.00 per share, if the net profit remains at $1.00 per share. They ~~might~~ will ~~want to~~ delay ~~a stock issue~~ introducing the B stock on the stock market beyond the fourth year if they cannot obtain a price for the B Stock about 6 times earning. It is not likely that the stock will be introduced on the stock market as high as 8 times earning or higher, but it is conceivable that this might happen. It should be noted that assuming a net profit of $1.00 per share, each A Share will receive a dividend of $100. Sometimes during the first year, it will be possible to say with certainty, that the dividend in that year will be in effect $100. per share. At ~~After~~ that time the shareholders might offer the University of Chicago, for sale 15,000 A Shares and $\frac{15,000 \times 300}{8}$

B Shares (about 560,000 to 570,000 B Shares) on the following terms: The university will make a first cash payment of $1,500,000 at the time of sale and it will make a second and final payment after conversion into B Stock has taken place, at the time when the B Stock is introduced on the stock market. At that time the university will pay for each A Share $\frac{300}{8}$ (= 37.6) times the market price of one B Share and it will pay for each B Share it has bought, either the market price of the share or else 8 times the average earning of the company per share for the second, third and fourth year, whichever of these two is less. As stated above, it is likely that the market price of the B Shares will be ~~of~~ less ~~value~~.

It is easy to show that on this deal ~~that~~ the university cannot lose anything. If the B Shares should sell on the market at 8 times earning, or above, the university will not lose anything, nor gain anything. If ~~it should be likely that~~ the market price of the B Shares is less, the university will earn something without having taken any real risk. Assuming that the net earning of the company in the first four years remain at $1.00 per share, the company will have paid out in dividends $6,000,000 during that period. If the B Shares are introduced on the stock market at $6.00 per share, the university will ~~have~~ make 9/8 of one million ~~dollars~~. If the market price of the shares is somewhere between $6.00 and $8.00, the university will make less on the deal, and if the price is $8.00, it will make nothing. If the price is above $8.00, the university has no gain ~~and~~ but neither has the university any loss.

Corr.

To: Walter Blum
From: Leo Szilard

June 18, 1953

MEMORANDUM CONCERNING SALE OF STOCK TO THE UNIVERSITY OF CHICAGO

The purpose of this memorandum is to raise certain legal questions by means of a concrete example.

A Closely Held Corporation with, say, 1,500,000 shares issued is reorganized so that the stockholders obtain in place of the presently held shares 1,500,000 new shares, of which 15,000 are A Shares and the rest are C Shares.

These shares are issued with the following provisions: While the A Shares may receive dividends in the first four years, the C Shares will receive no dividends in the first four years. After four years, both the A Shares and the C Shares will be converted into B Shares. At that time one B Share will be given in exchange for one A Share and one B Share will be given in exchange for one C Share. There is a further provision which says that during the first four years the net current profits must be paid out in full in the form of dividends. It is contemplated to ~~have~~ ~~a stock issue of~~ introduce on the Stock exchange the B Shares sometime within three years after the conversion of the A Shares and C Shares into B Shares.

Let us assume now for the sake of the example, that the company has a net profit of $1.00 per share per year and that there will be almost certainly a total net profit of $1,500,000. during the year in which it is reorganized and a likelihood that the net profit of the company might remain at $1.00 per share in the subsequent years.

Under these assumptions, the present shareholders might be willing to part with the B Shares when the stock is ~~poured out~~ introduced ~~into~~ on the stock market at perhaps 6 times earning, i.e. $6.00 per share, if the net profit remains at $1.00 per share. They ~~might~~ will ~~wish to~~ delay ~~a stock issue~~ introducing the B stock on the stock market beyond the fourth year if they cannot obtain a price for the B Stock about 6 times earning. It is not likely that the stock will be introduced on the stock market as high as 8 times earning or higher, but it is conceivable that this might happen. It should be noted that assuming a net profit of $1.00 per share, each A Share will receive a dividend of $100. Sometimes during the first year, it will be possible to say with certainty, that the dividend in that year will be in effect $100. per share. At ~~after~~ that time the shareholders might offer the University of Chicago, for sale 15,000 A Shares and $\frac{15,000 \times 300}{6}$

B Shares (about 560,000 to 570,000 B Shares) on the following terms: The university will make ~~its~~ a first cash payment of $1,500000 at the time of sale and it will make a second and final payment after conversion into B Stock has taken place, at the time when the B Stock is introduced on the stock market. At that time the university will pay for each A Share $\frac{300}{8}$ (= 37.6) times the market price of one B Share and it will pay for each B Share it has bought, either the market price of the share or else 8 times the average earning of the company per share for the second, third and fourth year, whichever of these two is less. As stated above, it is likely that the market price of the B Shares will be ~~at~~ less~~er value~~.

It is easy to show that on this deal ~~that~~ the university cannot lose anything. If the B Shares should sell on the market at 8 times earning, or above, the university will not lose anything, nor gain anything. If ~~it should be likely that~~ the market price of the B Shares is less, the university will earn something without having taken any real risk. Assuming that the net earning of the company in the first four years remain at $1.00 per share, the company will have paid out in dividends $6,000,000. during that period. If the B Shares are introduced on the stock market at $6.00 per share, the university ~~would have made~~ will make 9/8 ~~of~~ of one million. If the market price of the Shares is somewhere between $6.00 and $8.00, the university will make less on the deal, ~~it~~ and if the price is $8.00, it will make nothing. If the price is above $8.00, the university has no gain ~~and~~ but neither has the university any loss.

Stockholders get if 6 times earning is the market price.

$$6\,\frac{300}{8}\,15000 + \frac{300\quad 15{,}000}{8}\,6 + 1{,}500{,}000$$

$$= 1.500{,}000 + \frac{6}{8}\,300\quad 30{,}000$$

$$= \quad '' \quad + \frac{6\times 9}{8}\,10^6 = 1.500000 + \frac{48}{8}10^6$$

$$= \begin{array}{r} 1.5 \\ 6 \\ \hline 7.5 \end{array}$$ million

THE UNIVERSITY OF CHICAGO

CHICAGO 37 · ILLINOIS

THE LAW SCHOOL

November 24, 1953

Dr. Leo Szilard
King's Crown Hotel
420 West 116th Street
New York, New York

Dear Leo:

I am writing you instead of telegraphing this message in order to state the qualifications which I feel should be added to my general answer.

It is my opinion in general that your latest plan probably does not have any serious tax infirmities. I believe it is highly probable that the transaction would be regarded as constituting a sale by the seller to the tax exempt purchaser. Dividends paid after the sale would be attributable to the purchaser. In effect, the purchaser would be in a position to use the tax exempt dividends to pay for the shares. There are two qualifications, or reservations, which I would like to introduce.

One is that it is conceivable that the sale would not be regarded as taking place all at once in a single year; but rather the seller would be regarded as selling a certain number of his shares each year as the purchaser made a payment according to the plan. That is, so long as the purchaser had an option to return a given number of shares, ~~since~~ such shares would not be regarded as sold. Normally, the transaction would not be characterized in this manner, but given the atmosphere in which this transaction is conceived, it is not impossible that the Treasury would hit upon this analysis as a means of stopping "tax avoidance". Were the Treasury to prevail in this respect, the transaction would backfire as far as the seller is concerned, since he would be charged with the dividends paid on the "unsold shares." On the whole, I am inclined to think that the Treasury would not urge the position I have suggested, and would not be successful if it did try this approach.

My other qualification concerns the purchase price; a matter which was not introduced into our conversation. If the purchase price is within the range of prices which the seller could reasonably expect to receive from private buyers, it is unlikely that the transaction would draw fire. On the other hand, if the price is substantially higher than the topmost limit of that range, I would have considerable reservations about advising a publicly minded tax exempt institution to participate in the deal. While it is possible, or even likely, that the transaction would be technically "all right" even at the inflated price, in the eyes of some persons, the deal would not be free from taint. After all, the tax exempt purchaser would be using its exemption to reward the seller with a higher purchase price, thus, in effect, sharing benefits of the exemption with the seller.

Having displayed my usual conservatism, let me also say your proposed plan impresses me as carrying far less potential taint than many of the schemes now being indulged in by some educational institutions and by many pension trusts. Perhaps my sense of tax morality is simply lagging behind the times. In that event, I urge you to make haste in putting the perspective seller in touch with the University of Chicago at once.

Best regards.

As ever,

Walter

Walter J. Blum

wjb/pt

25 x
magazines

10⁶ times

many times

10 own group

All leprosaria
in world
in 1 year

100,000

75,000

30

$\boxed{200,000}$

3

Sheraton-Park Hotel
Washington 8, D. C.

July 13, 1955

Mr. Walter Blum
The Law School
University of Chicago
Chicago 37, Illinois

Dear Blum:

Enclosed you will find three documents marked 1, 2 and 3 which describe to you the project that I am trying to set up. Whether I shall succeed I do not know yet, but the University has given me a year in which to try to do this.

Attached is a list of names who are potential members for the full-time working group. For the time being I am merely slowly exploring which of them might be available. In the end we will not need more than five or seven of them. The most interesting response so far is from Father Cavanaugh, which I attach.

The 13,000 page memorandum which is enclosed (Exhibit 3) is an attempt to define the spirit of the general approach. The details are not important. It is not suitable in its present form for publication and I am rewriting it with publication in view.

The purpose of this letter is to officially inquire whether the Law School might be willing to administer funds, if this project is in fact set up and funds are made available. Since the funds would be for the purpose of the work of the ~~Commission~~ "working group" and the job of the ~~Commission~~ working group is to conduct an inquiry, it would be proper for a tax exempt institution to accept the administration of the funds.

The Dean of the Social Sciences Division, Mr. Chauncy D. Harris, wrote me as of July 7 that the Social Science Research Committee, which passes on all research projects, will not approve this project for outside financing in the name of the Division of the Social Sciences. This is my reason for raising the question with the Law School. If the Law School is willing to take on the project, it will still be necessary to clear it with the Board of Trustees, but this could wait until funds are in sight. At this time I assume that half of the funds may come from the Russian Government and the other half from various American foundations and private persons.

I shall remain in Washington until Congress adjourns.

Would you please take this up at your convenience with the other members of the Law School and above all, Ed Levi, and let me know how you feel about it?

If the Law School rejects the project, let me know whether you can think of another division in the University that might be willing to handle it, or whether you think I should proposition some other University.

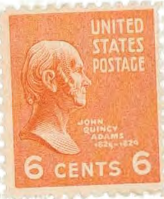
With kind personal regards,

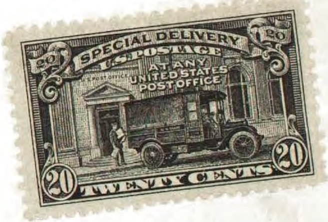
Sincerely yours,

LS:srr

Leo Szilard

Enclosures





AIR MAIL

SPECIAL DELIVERY

Mr. Walter Blum
The Law School
University of Chicago
Chicago 37, California

Dr. Leo Szilard
1155 East 57th St.
Chicago 37, Illinois

Calvin Blum

Mrs Borge...

Cord Meyer
Moffit... adler

Barry Bingham
Louisville Courier
Journal

(Leland Hazard)

Harris Wofford

(Archer Bowles)

(Arthur Compton)

Hutchins

George ~~Stoddard~~ ?

Harris Wofford says
Abram Chayes (his law firm)

Asst. Prof. Harvard

Acheson says thinkers:

Nitze
Halle
Marshall

Stevenson's men

President of Bell & Howell
Chicago

Percy

Dick Bolling

Mrs Burgess

Alan Brodel
Robert Redfield

Tony Vaorhis

? Frank Graham ?
Clarence Faust

Rogers Swing
(Agnes Montine)

Bish. Sheil ?
Harrison Brown

Judge Mantatis
? Andy Newton ?
For [illegible]
Irving Salomon